

Tax Restructuring Proposal FY 2008 Budget

**Robert J. Kleine
State Treasurer
February 8, 2007**

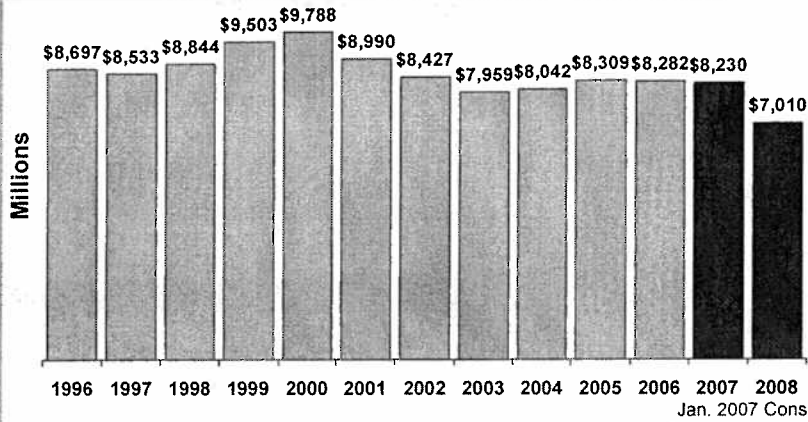
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Topics Covered

- Revenue picture
- Tax cuts of the 1990s
- MBT changes
- Additional elements of tax proposal

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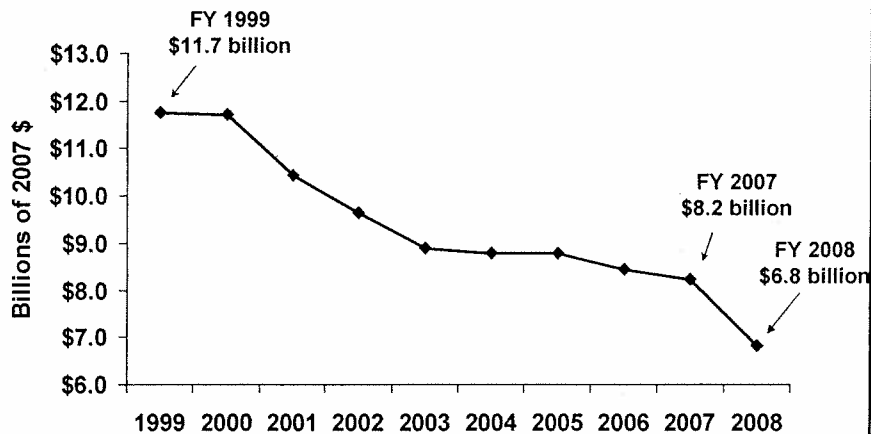
Nominal General Fund Net Revenue in 2007 Less Than in 1996



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Note: Totals exclude transfers and savings from adjusting statutory revenue sharing payments to local governments. 2008 drops due to SBT repeal.

Inflation Adjusted FY 07 GF-GP Revenues Down 29 Percent Since FY 99



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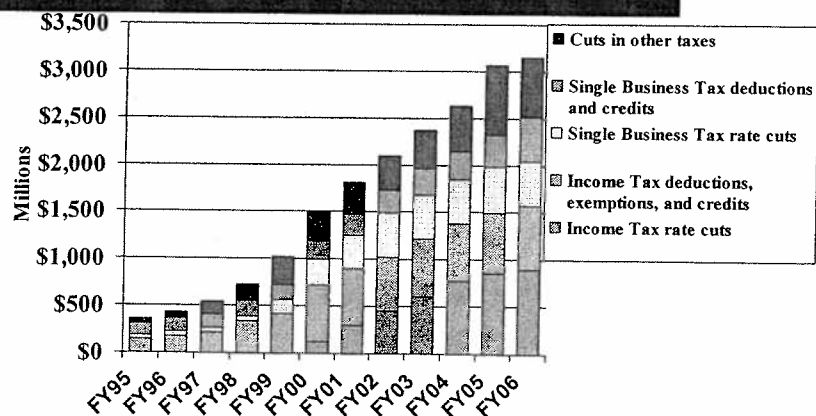
Totals exclude transfers and are adjusted to 2007 dollars using U.S. CPI-U.

Revenue at Extreme Historic Lows

Fiscal Year	Governor	Inflation Adj GF Revenue (2006\$)	% Above 2006
1973	Milliken	\$11,820	43%
1978	Milliken	\$12,129	47%
1989	Blanchard	\$11,649	41%
1999	Engler	\$11,518	39%
2000	Engler	\$11,496	39%
2006	Granholm	\$8,267	

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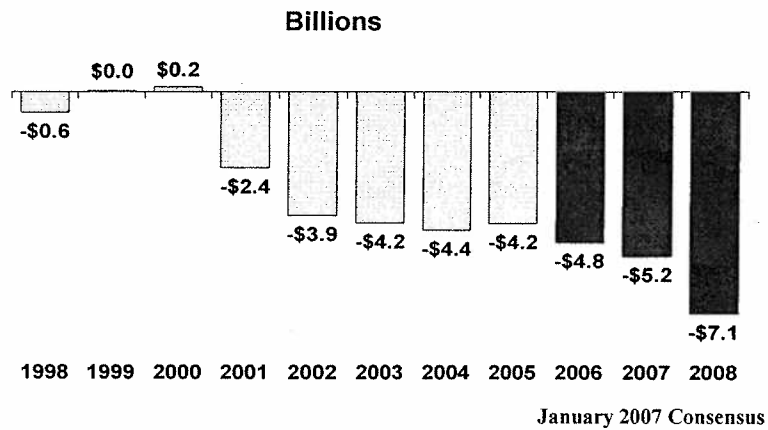
Tax Cuts Since Proposal A Total \$3.2 Billion in FY 2006



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Note: Totals above are tax cuts only and do not include the effects of the gasoline, casino, and cigarette tax increases which generate \$870 million per year

Constitutional Revenue Limit Calculation



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Michigan's Defining Moment

**"...we all hate taxes,
but we love Michigan more"**

Craig Ruff, Public Sector Consultants

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Source: Detroit News February 1, 2007

Elements of the Plan

- MBT with changes suggested by business community
- 2% tax on services excluding education and healthcare
- Federally decoupled estate tax applicable to 350 estates a year worth more than \$2 million
- Increase in OTP and \$0.05 cigarette tax increase
- Increase in liquor markup
- Elimination of certain loopholes
- Sales tax break for car buyers based on the value of a car traded in for a new vehicle

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Effects of Tax Changes

- Plan will recapture about 1/3 of tax cuts of last decade
- Michigan's business and overall tax burdens will remain below the national average
- The replacement for the SBT will make Michigan a more attractive place for businesses
- Makes Michigan's tax structure more responsive to economic growth
- Allows us to invest in education and healthcare to make Michigan more attractive for businesses and our citizens

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Michigan Business Tax

- Tax base consists of sales, assets, and income
- Broad base allows for rate of 0.125 percent on sales and assets – the lowest rate in the country!
- Tax rate on profits just 1.875 percent, well below any other state's corporate income tax rate¹
- Includes special features for small businesses
- Provides personal property tax relief

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1. Alaska and Arkansas have corporate rates that start at 1 percent but have substantially higher top corporate rates.

Changes to the MBT

- Change definition of financial organizations
- Subtract sales of intangible assets from gross receipts
- Eliminate double taxation of corporate partnerships
- Subtract inter-company sales among affiliates from gross receipts
- Exclude foreign assets and tax deferred assets from the base
- Provide a credit for high paying jobs provided at corporate headquarters

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MBT Cuts State's Major Business Tax

- Headquarters credit reduces taxes by \$240 million
- Other changes reduce the MBT by an additional \$240 million so the MBT raises \$480 million less than the SBT would
- \$578 Million tax cut for Michigan businesses
- \$250 million tax cut for small businesses
- 111,000 firms pay less MBT than SBT while 33,000 firms pay more

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Personal Property Tax Relief

- Industrial and commercial personal property will be exempt from the 6 mill state education tax and the 18 mill local school operating tax
- The exemption amounts to an average reduction of 46 percent in personal property taxes
- This change does not affect city, township, or county taxes
- Cut lowers personal property taxes by over \$600 million per year

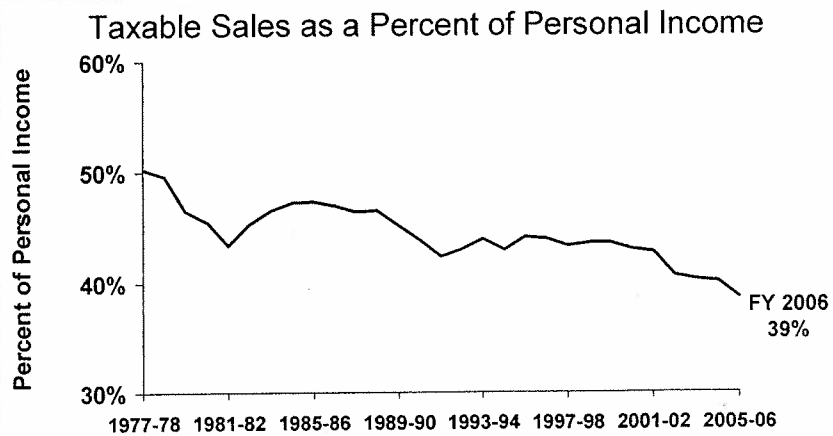
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MBT Cuts for Service Businesses

<u>Service Category</u>	<u>% Tax Reduction</u>	<u>% Paying Less</u>
Accounting Services	-50.8%	93.6%
Legal Services	-66.0%	91.3%
Auto Repair Shops	-63.3%	91.4%
Dry Cleaning	-67.4%	89.9%
Engineering/Architectural	-69.8%	91.3%
Total For All Services	-33.2%	83.0%

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Sales Tax Share Declining



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State Taxation of Services

- Based on a survey by the Federation of Tax Administrators, Michigan currently taxes 26 out of 168 services
- Michigan ranks 39th highest
- On average, states tax 55 services, more than twice as many as Michigan

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State Taxation of Services

State	Number of Services Taxed	Rank
Hawaii	160	1
Washington	157	2
New Mexico	156	3
South Dakota	146	4
Delaware	143	5
Wisconsin	74	11
Ohio	68	16
Minnesota	67	17
Michigan (current law)	26	39
Indiana	23	41
Illinois	17	46

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Taxing Services

- Proposing a 2 cent tax on services beginning June 1
- Tax base would include professional entertainment, repair and maintenance services, construction services, legal and accounting, and personal care

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Exempt Services

- Some services excluded from tax are
 - Healthcare and education
 - Daycare
 - Religious services
 - Sales to non-profits and governments
 - Services provided for agricultural production
 - High school and college sports admissions
 - Museums, historical sites, zoos, and parks
 - Scientific research and development

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Examples

1. \$25 pedicure – cost with tax \$25.50
2. \$35 greens fees for golf – cost with tax \$35.70
3. \$100 theater tickets – cost with tax \$102.00
4. \$250 labor charge on repair bill – cost with tax \$255.00
5. \$5,000 consulting bill – cost with tax \$5,100

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Sales Tax on the Difference

- Allows trade-in allowance to be deducted from price of new car when calculating sales tax starting October 1
- Change would bring Michigan's practice in line with most other states
- Tax reduction of \$180 million per year

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Taxpayer Example

	Income = \$57,300	
	Basic Example	More Complex Example
Est. Sales Tax	\$1,087	\$1,087
Est. New Service Tax & Loopholes	\$69	\$69
Total Tax Including Services	\$1,156	\$1,156
Estimated Tax Increase	\$69	\$69
\$25k Home Renovation - Sales Tax	NA	\$623
\$25k Home Renovation - Service tax	NA	\$292
Total Estimated Tax Increase	\$69	\$361
Vehicle Trade-in (\$10,550 avg)	NA	-633
Total Estimated Tax Increase	\$69	-\$272

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Estate Tax Decoupling

- Federal law changes made in 2001 effectively ended Michigan's estate tax
- "Decouple" proposal would base Michigan's tax on 2001 federal law
- 18 states and the District of Columbia have decoupled
- No tax for estates valued less than \$2 million
- Assets attributable to family owned businesses and farms exempt
- Effective rates after federal deductibility close to 5%

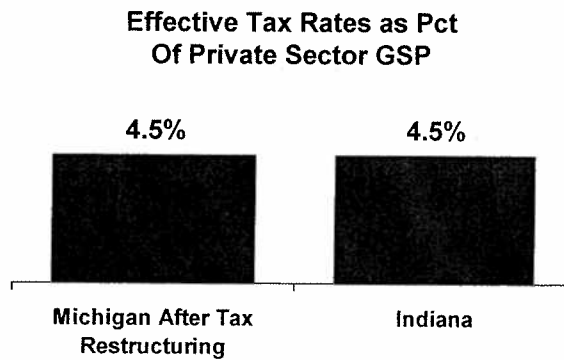
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Tax Burden After Changes

- Michigan state and local business taxes as a percent of GSP will be 4.5% compared to U.S. average of 4.8%
- Michigan's total state and local tax burden will be 10.66% of personal income compared to a national average of 10.75%

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Michigan's Business Tax Burden Will Be the Same as Indiana's



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Source: COST Analysis, with Michigan after restructuring calculated
By the Michigan Department of Treasury

Overall Balance Sheet

	<u>CY 2007</u>	<u>CY 2008</u>	<u>CY 2009</u>	<u>CY 2010</u>
Net Effect SBT Replacement	\$0.0	(\$457.7)	(\$468.6)	(\$467.4)
Service Tax	\$845.5	\$1,484.6	\$1,529.2	\$1,575.0
Loopholes & Other Increases	\$95.1	\$190.2	\$194.3	\$198.6
Estate Tax	\$29.8	\$120.1	\$134.9	\$138.9
Sales Tax on Difference	<u>(\$43.8)</u>	<u>(\$176.3)</u>	<u>(\$181.6)</u>	<u>(\$187.0)</u>
Net Effect Restructuring	\$926.6	\$1,160.9	\$1,208.2	\$1,258.1
EITC	<u>\$0.0</u>	<u>\$0.0</u>	<u>(\$127.9)</u>	<u>(\$283.6)</u>
Net Revenue with EITC	\$926.6	\$1,160.9	\$1,080.3	\$974.5

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Timing Issues

- The SBT replacement must be enacted rapidly to remove uncertainty for businesses to allow them to prepare
- The service tax needs to be enacted quickly to avoid mid-year cuts to education and vital services

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